

Letter from  
the President

Most simply stated, the ABTL's mission is to make the courtroom a more comfortable place for lawyers who try business cases. The challenges of the courtroom ought to come from the facts and the law, not from unfamiliarity with the surroundings. Judges who participate in our programs have the opportunity to tell us how they — and their juries — like to see

things done; our members have the opportunity to show judges emerging techniques they want the freedom to use in presenting their cases. Understanding how experienced trial lawyers develop their approaches to the courtroom, and hearing judges explain their reactions to the many different ways they've seen cases tried, helps all of us who try cases feel more comfortable in preparing to answer "ready." No organization more consistently and effectively provides a forum for this important exchange between bench and bar than does the ABTL.



Jeffrey C. Briggs

Accordingly, ABTL dinner programs and annual seminars focus on trial techniques and tactics rather than on substantive or pretrial procedural law. Our lunch programs provide a forum in which to address specific substantive areas of the law and pretrial litigation, but we often gear these programs toward younger lawyers and those who mentor them as they prepare to enter the courtroom on their own. This will continue to be our approach over the next year. There is no substitute for personal trial experience, but training by watching others certainly has its place. The ABTL will continue to be that place.

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Division Proposal Jeopardizes  
Consistency of Circuit Law

In December 1998, the Commission on Structural Alternatives for the Federal Courts of Appeals, chaired by Retired Supreme Court Justice Byron R. White, submitted to the Congress and the President its Final Report (located on the Commission's web site: <http://app.comm.uscourts.gov>). In January 1999, Senators Murkowski (Alaska) and Gorton (Wash.) introduced S. 253, The Ninth Circuit Reorganization Act of 1999, to implement the Commission's proposals.

The Commission strongly recommended keeping the Ninth Circuit together as a single administrative unit, stressing the importance of having a single court interpret and apply federal law in the western United States and the Pacific Rim. It further proposed restructuring the court of appeals into three autonomous adjudicative divisions, an action that would have the opposite effect of diminishing the court's ability to provide consistent and stable law across the nine-state region. This article briefly describes the proposed legislation, how it might affect California business lawyers, and the steps the court is taking to respond to the Commission's concerns.



Hon. Procter Hug, Jr.

Findings and Recommendations

The Commission's principal recommendation was that the Ninth Circuit should not be split:

There is no persuasive evidence that the Ninth Circuit (or any other circuit, for that matter) is not working effectively, or that creating new circuits will improve the administration of justice in any circuit or overall. Furthermore, splitting the circuit would impose substantial costs of administrative disruption, not to mention the monetary costs of creating a new circuit. Accordingly, we do not recommend to Congress and the President that they consider legislation to split the circuit. (page 29)

Although the Commission concluded that no objective data, and no substantial subjective findings, justify a major structural change, it nonetheless proposed the following divisional restructuring:

- The court of appeals would be reorganized into three regionally-based adjudicative divisions to hear and decide all appeals from the district courts in their divisions:

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*Northern Division* — Districts of Alaska, Idaho, Montana, Oregon, and Eastern and Western Washington.

*Middle Division* — Districts of Eastern and Northern California, Guam, Hawaii, Nevada, and the Northern Mariana Islands.

*Southern Division* — Districts of Arizona, Central and Southern California.

- Each active judge would be assigned to a particular regional division; each division would consist of seven judges or more, depending upon the caseload. A majority of the judges in each division would be residents of the division, but each division would include some non-resident judges assigned randomly for three-year terms.

- Each regional division would function as a semi-autonomous decisional unit, sitting in panels and *en banc*. Decisions made in one division would not bind any other division but should be accorded substantial weight by the other two divisions.

- A Circuit Division for conflict resolution would resolve conflicting decisions between two regional divisions. Comprised of 13 judges — the chief and four judges chosen by lot from each division for three-year terms — the Circuit Division's jurisdiction would be discretionary and could be invoked by a party after a divisional *en banc* decision or denial of an *en banc*.

### The System Is Working Well Now

Why should California business trial lawyers be concerned about the Commission's proposal for restructuring the Ninth Circuit? The question essentially becomes whether the structural changes better serve the prime objective of maintaining a consistent body of coherent federal case law throughout the circuit. I believe they do not — nor do the chief judges of eight other federal circuits, the Department of Justice, and more than a dozen other bar organizations and key political leaders who have submitted comments opposing the divisional structure to the Commission.

The Commission's own surveys show that the vast majority of judges and lawyers within the circuit believe that the Ninth Circuit is operating well in its current structure. The court of appeals has a viable mechanism that maintains the consistency of the law throughout the circuit. Every decision of a three-judge panel is binding throughout the entire circuit, not just in one unit or division. The limited *en banc* procedure for reviewing conflicts and cases of exceptional importance provides a mechanism for all judges to participate in the process of selecting a case for review and for making their views known. Once a case is taken *en banc* and resolved, the decision becomes the law of the circuit which all later panels recognize and follow. Nor is there an additional layer of appeal, as there would be with the divisional approach.

### The Divisional Structure Frustrates Consistency

As the Commission itself stated in favor of keeping the circuit together:

Having a single court interpret and apply federal law in the western United States, particularly the federal commercial and maritime laws that govern relations with the other nations on the Pacific Rim, is a strength of the circuit that should be maintained. (page 29)

However, a closer look at the proposed divisional structure shows that it would have the opposite effect on circuit law:

- Neither the panel nor the *en banc* decisions of a division would have a binding precedential effect on the other two divisions. A circuit-wide *en banc* hearing for any purpose other than

resolving direct conflicts would be abolished.

- The proposal would eliminate the participation of all judges circuit-wide in resolving circuit law. Circuit-wide law would be replaced by divisional law which would be developed only by the judges sitting in a single division.

- The likelihood of inconsistent interpretations of federal law would exist throughout the circuit and would not be adequately addressed by the Circuit Division, which would oversee only direct conflicts between two divisions.

- Federal law for California would be established by two different divisions (Middle and Southern), creating the potential for different interpretations and enforcement of the same law in different parts of a single state.

- The Circuit Division is a new level of appeal before finality, resulting in additional expense and delay for litigants.

- The chief judges of the First, Second, Third, Fourth, Fifth, Seventh, Eighth, and D.C. Circuits strongly opposed divisional restructuring, stating that, "[T]he whole concept of intra-circuit divisions, replete with two levels of *en banc* review, has far more drawbacks than benefits."

### Adverse Impact on California

Senator Dianne Feinstein, in her comments to the Commission, wrote:

[I]t would be disastrous if California were split into Northern and Southern [Divisions]...[which] would not be bound precedentially by each other's decisions. Lawyers would engage in "forum shopping" within the same State for favorable rulings. California corporations subject to federal jurisdiction could be subject to varying interpretations of the same federal and state laws. This could compel businesses to build headquarters in other States where there is no conflict within the federal court system. The lack of uniformity and certainty in the law could create chaos in our state. Imagine if two California divisions disagreed on the constitutionality of any state-wide initiative or law. This could do extraordinary damage to Californians' faith in the integrity and fairness of the judicial system. (Letter of December 3, 1998, to Justice White)

Nor would placing California in a single division resolve the flaws in the divisional structure. The situation would remain the same, since no single entity would have the ability to establish the law for the entire circuit.

### Conclusion

While the judiciary is indebted to the Commission for its valuable and independent work, the evidence simply does not support change to a divisional structure for the Ninth Circuit Court of Appeals. The disadvantages of such a structure far outweigh the claimed advantages of increased collegiality and a smaller body of law to master. The Ninth Circuit has never hesitated to evaluate and modify its procedures; there is always room for improvement. But such an untried proposal does not justify scuttling the Ninth Circuit's time-tested mechanisms for maintaining consistency which are operating efficiently and effectively.

Last spring, I appointed a 10-member Evaluation Committee, chaired by Senior Circuit Judge David R. Thompson of San Diego, to review areas of concern raised by the Commission. Consisting of judges, lawyers, and an academic, the committee will make recommendations to the court for correction. This is a far less disruptive and more constructive approach to achieve the goal we are all striving for — a fair and efficient judicial system.

*While these remarks are my own, they reflect the position of two-thirds of the members of the court.*

—Hon. Procter Hug, Jr.

## Jury Trials Do's and Don'ts As Seen from the Bench

**T**rial lawyers frequently ask for my candid opinion about improving the presentation of their case at trial, particularly during trial. At the request of one of the ABTL editors, I have attempted to articulate a "non-exhaustive" list of do's and don'ts and general observations about positively impacting the court and the jury.

*Pay attention to subtle cues you receive from the jury.* Body language is often a good indication of what is going on in the juror's mind. For example, watch for jurors with crossed arms, jurors not taking notes, particularly if all the jurors are not taking notes. Are the jurors staring into space during testimony or cross examination? Are they day dreaming and rolling their eyes when an attorney or witness speaks? These are subtle messages which a trial lawyer needs to incorporate in adjusting his or her case before the jury.

*Be aware of what is going on in the courtroom.* Are witnesses being given cues by counsel or spectators in the courtroom? Is the plaintiff with a back injury moving uncomfortably in his seat or standing in the back of the courtroom in genuine pain while the defense argues that there is no injury? If the pain appears to be genuine, is this a good time to settle? If not, does the defense address the plaintiff's "contrived" discomfort in closing?

*Avoid having too many lawyers and other legal professionals at counsel table or in the courtroom.* Sometimes an overabundance of professionals looks like a military formation

about to attack the judge and the jurors.

*Listen carefully to the witnesses' answers.* Sometimes an answer to a question satisfies the substance of the attorney's next question.

*Avoid long breaks between the answer and the next question.* Lawyers who take extensive notes during direct or cross examination frequently bore the jury and interrupt the flow of the testimony. If the attorney takes a rare note, the jury will think the witness' response was important and tend to write down the same answer, following the attorney's lead.

*If using demonstrative evidence, use blow-ups that can be seen by all in the courtroom.* For example, rent a big screen with a projector or have multiple copies for the jury. If the jury can't follow evidence at the time it is being introduced, the impact is lost and often the jury forgets what may be important in that particular piece of evidence.

*Do not become so "high tech" that you lose control of the trial or examination.* Equipment and technical problems can be a real distraction to your case.

*Be prepared with exhibits needed at the start of each court session.* Jurors (and the judge) become very bored watching the examining attorney strut about the room, wasting time, not asking questions, putting exhibits in



Hon. Victoria G. Chaney

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## Selling Your Case to the Jury

**B**ecause of the complexity, cost and risks of prosecuting or defending a case through trial, most business litigators do not get a chance to get in front of a jury often enough. While there are several worthy trial advocacy courses that may assist our trial skills, sometimes it would help to have an abbreviated bullet-point outline of strategies for effectively selling your case to a jury. In this issue, we address such an outline from the point of view of a business trial attorney as well as a trial judge (see above).

*Opening Statement.* This is your first real opportunity to tell your side of the story. You want the jury to remember your opening statement. There are several ways to accomplish this goal, the most important of which is to create a simple theme you will be pursuing throughout the trial. One effective method to create a lasting image in the jury's mind is through demonstrative exhibits that you must obtain prior approval for by opposing counsel and the judge. For the business case, a demonstrative exhibit frequently could be an easy to understand, overblown color graph or chart. For example, if you are representing a plaintiff in a partnership dispute where one partner has breached his fiduciary duty by stealing partnership opportunities, consider a good graphic illustration. Perhaps color charts comparing the growth and sales of the partnership before and after defendant partner began stealing business opportunities of the partnership. This exhibit could be used over and over again during the course of the case and could easily serve as one central theme the jury can remember.

Keep your opening statement short and avoid reading from a script.

*Direct Testimony.* Prepare your witness and exhibits well in advance. Avoid making your witness an advocate as opposed to an individual who is truthfully answering only the questions asked. Witnesses who consistently provide answers beyond the scope of the question not only face distracting motions to strike, but also risk a loss of credibility.

The same is true of cross-examination. Witnesses who attempt to sidetrack cross-exam questions severely damage their credibility. It is far better to deal with bad evidence on direct. Your witness should be encouraged to answer tough cross-examination. The jury may ignore a bad piece of evidence or a bad fact but it typically will not forgive the evasive "slippery" witness.

Anticipate objections to testimony and exhibits that could interrupt the flow of your direct. If you know you are going to examine a witness at the end of a day, try to end the testimony on that day with a "zinger." On direct, a "zinger" is a particularly persuasive piece of testimony or evidence in your favor that you want the jury to remember over the weekend. On cross-examination, a "zinger" is a particularly damaging piece of evidence, or impeachment that is intended to impact the jury and will leave the other side shaken over the weekend.



Larry C. Russ

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## *Jury Trials Do's and Don'ts*

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place or digging through briefcases or the evidence box looking for misplaced exhibits.

*Avoid sarcasm* — too much can cause a backlash against the attorney and his or her client. A little humor is fine. Vituperative attacks directed at opposing counsel, the witness or the judge tend to make jurors uncomfortable.

*Do not make faces if the ruling is for or against you* — jurors watch the attorneys carefully.

*Avoid repeating the same questions.* This practice makes the jury and judge think that the attorney is lost, is killing time, or does not have a case.

*Avoid reading opening statements or closing argument.* Use a key word outline and practice the argument first, preferably with a tape recorder or videotape.

*"Shorter is better"* — get to the point and get in and out of a subject quickly. We are a "sound bite society" and jurors tend not to retain great masses of information presented to them all at once.

*Be truthful to both the judge and the jury.* If an attorney cannot be trusted, the client often suffers.

*Pay careful attention to what a judge is saying in a ruling.* A ruling on an objection to an examining attorney's question, for example, may contain a clue as to how to circumvent the objection legitimately.

*Choose objections wisely.* Many questions may be objectionable, but not harmful to the case. Constant objections may preserve the client's rights on appeal, but appear to the jury that the attorney or client has something to hide.

*Anticipate evidentiary issues before the trial starts.* Ask the court to rule on as many issues as possible to help plan the presentation of your case or defense as well as avoid wasted jury days.

*Give the judge credit for reading and understanding your legal arguments.* The most effective oral argument is that which focuses on particular questions or issues posed by the court. Repeating arguments fully addressed in your briefs is typically counter-productive unless you are targeting a particular issue you "genuinely" believe the court has somehow misperceived.

— Hon. Victoria G. Chaney

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## *Selling Your Case to the Jury*

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*Trial Objections.* It is very common for trial lawyers to object to any question that is objectionable, even as to the form of a question, regardless of the subject matter or importance of the testimony. This practice is inadvisable for a number of reasons: (a) judges generally don't appreciate this practice; (b) it unnecessarily extends expensive trial days; and (c) most important, juries are turned off by it.

If you object to everything under the sun, juries start to ignore your objections and stop paying attention when you do object. Another risk is that the jury may believe that you are trying to hide something. Make your objections count and save them for the important issues.

*Cross Examination.* "Less is more." Avoid trying to utilize an adverse witness to prove your own case. Cross examination should be employed as a surgical tool to challenge the credibility of a witness' testimony and establish as many contradictions as possible. Convincing a jury to disbelieve the testimony of an adverse witness is about the best thing you can hope to accomplish. Trying to do more too often leads to potential disaster.

Cross examination should be carefully organized and prepared well in advance of the adverse witness' testimony. Inconsistent

testimony and exhibits should be available within seconds to impeach a witness. Give a lot of thought to the order of cross examination. Write out complete leading questions. Think about the answers you are likely to get and compare them to deposition testimony, if available. Your objective is to target the most critical part of the witness' testimony. Impeaching a witness on insignificant facts is counterproductive. The jury will lose interest in your cross examination and you will lose credibility with the jury. Get to the point quickly and know where you are going.

*Courtroom Manners and Etiquette.* Your best friend is the arrogant attorney on the other side. Jurors generally do not like mean-spirited, arrogant or impolite attorneys. Similarly, jurors do not typically like attorneys who point or yell at the witness during cross examination, who mumble derogatory comments under their breath, bang on chalk boards, bang on tables, or do not show appropriate respect to the judge. Respect for the judge is especially important if you happen to have a judge that is particularly nice to the jury even though he or she may be giving you a hard time.

*Courtroom Psychology and Demeanor.* Thou shall not talk down to the jury! No matter what the jury looks like, collectively they are typically much smarter than you may believe. Don't worry so much about whether they get it, they typically do! So focus on getting the important facts in and lose all the redundancy.

While you are not allowed to communicate directly with any jurors, either inside or outside of the courtroom, it is perfectly appropriate for you to attempt to make eye contact whenever possible. This makes individual jurors feel important and helps them pay attention. Nodding hello and good-bye to the jurors as they enter and leave the courtroom is one way of creating a rapport with jurors, especially in a lengthy trial. Jurors who are particularly friendly on their way in or out of the courtroom are more than likely on your side. However, don't be fooled by jurors who will not make eye contact with you. You never know what a juror is thinking. Some take admonitions seriously about avoiding all contact with counsel, including eye contact.

Be yourself at trial. You've got enough to worry about without having to concentrate on a personality makeover.

*Closing Argument.* Most judges allow the plaintiff to bifurcate the closing, allowing for a specified amount of time for rebuttal. Avoid shooting the moon before the rebuttal portion of your closing. Save enough time on rebuttal to make some points that your adversary will not have had an opportunity to respond to. The rebuttal portion of closing is frequently the most effective because it is usually from the heart and not completely scripted. Every attorney has life experiences from which he or she can draw. Jurors love real life analogies. Think about some of the legal issues in your case from the point of view of actual life lessons you have experienced. Analogies which draw from your personal experience to make an obvious point can be extremely effective and memorable to a jury.

If the case has been long or complicated, it is highly advisable to prepare large-scale, easy-to-read posters, summarizing the elements of each cause of action and listing, in bullet point fashion, the facts you have presented which satisfy each element. Juries like to have something to help them follow the closing. It is also easy for you to work with such oversized charts as a closing tool instead of standing at a podium and reading from your outline.

Finally, thou shall not insult a jury by telling them how to fill out a jury interrogatory or how to deliberate. Your job is to persuade the jury that the facts are as you have represented them to be and that you have satisfied your burden of proof on all causes of action. Let the jury know that you trust them to arrive at the appropriate conclusion through words and deeds.

— Larry C. Russ

Frequently overlooked in trial training is the role of the client. Lawyers are trained to get and keep litigation clients, clients are warned throughout pretrial proceedings about the vagaries of courtroom outcomes, and clients are trained to communicate to the jury from the witness stand, but the typical admonishment to clients at the outset of trial to maintain a neutral demeanor in the courtroom only contributes to the sense of mere spectator status many clients experience once the trial gets underway. Clients ought to be more than Dickensian shuttlecocks batted back and forth between the lawyers during trial.<sup>1</sup> To the extent our trial training efforts fail to actively involve those on whose behalf we swing the racket, we miss an important trial participant: The clients who pay not just some of their business revenue to their combatants, but who pay tax dollars for the court time and the referee as well.

While it is true that most litigation settles (and perhaps that even more litigation ought to settle), a quick tour of our local courthouses on any given day is a vivid reminder that cases still are being tried on a regular basis. Indeed, clients typically anticipate a trial from the outset; we trial lawyers and our judicial colleagues frequently are more responsible for getting cases settled than are the litigants. Clients also understand that no matter how many substantive "specialties" a lawyer might list in a firm brochure or on her or his own resume, trying cases to a judge or a jury, particularly "business" cases, is a specialty all its own. Clients turn to ABTL members because of our experience in communicating effectively with the factfinder, whatever the subject matter and regardless of the likelihood that a case will settle. Clients want to be prepared for the possibility of a trial from the outset, and the more our clients participate in the training we trial lawyers undertake outside the courtroom, the more effectively they can help us help them inside the courtroom in those cases where trial cannot be avoided.

Clients who attend ABTL programs also make important contributions to the education of the judiciary. Many local, state and federal judges attend our receptions and dinners even when not participating in our demonstrations and panel discussions. It is as important for members of the bench to hear and understand litigant perceptions and expectations of the judicial process, and particularly of the trial process, as it is for them to hear what jurors have to say about their experience. Understanding what motivates our clients also helps our judges understand what we trial lawyers are trying to accomplish at trial. It really is not always about money, the lawyers really are not always responsible for failing to settle, and for every issue that does go to trial there usually is at least one other issue that the parties have resolved on their own.

There is a place for clients, lawyers and judges to learn how to manage pretrial litigation, to learn how to settle cases, and to learn about new developments in the substantive law. From time-to-time the ABTL is a place for all those things. First and foremost, however, the ABTL is a place to learn about how cases that will go to trial can be tried efficiently and effectively. When judges talk about "How and Why You Should Make Your Case Presentation Shorter," as several of our local, state and federal judges did at our first dinner program this September, our clients also should hear them. When new judges are introduced to our members and talk about how they plan to run trials in their courtrooms and why (a perennial favorite program among our members), our clients also ought to get to know those judges. When a jury consultant shows a tape of mock juries deliberating, our clients also ought to see it. Put simply, if the topic involves what goes on inside the courtroom at trial, our clients need to be there. Making a place for a client at every table at every one of our pro-

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## Insured-Selected Independent Counsel: Rights and Limitations

When a client gets sued, one of the questions counsel should ask is whether liability insurance potentially may cover some or all of the claim or its defense. If the answer to that question is yes, a related question arises: Who is going to represent the insured?

Many times the client, for reasons of familiarity and confidence, wants to be represented by counsel it knows and has selected, oftentimes counsel it uses on a regular basis. Likewise, the originally selected counsel often wants to keep the business that has come its way. The carrier, though, often prefers that the case be handled by counsel with whom it is familiar and who it is confident will provide a professional, competent, and economical defense. This article addresses who — the carrier or the insured — has a right to select counsel, and the ramifications of that right.

### The History & Nature of the Insured's Right to Retain Independent Counsel

The established general rule is that the insurance carrier has the right to select counsel and to control the defense. *E.g., Western Polymer Tech., Inc. v. Reliance Ins. Co.*, 32 Cal.App.4th 14, 24 (1995) ("In general, the insurer is entitled to control settlement negotiations without interference from the insured."); *Foremost Ins. Co. v. Wilks*, 206 Cal.App.3d 251 (1988) (insured may not deprive carrier of its right to select counsel); *Clark v. Bellefonte Ins. Co.*, 113 Cal.App.3d 326, 335 (1980) ("The insurer thus has the right to control the defense of claims."). This rule is often grounded in the insurance contract itself, which typically provides that the carrier has both the duty and right to defend. It is also grounded in the fact that the carrier ultimately faces having to pay any resulting judgment and is going to be responsible for the defense expenses incurred.

But just as the carrier has the right to control the defense, it also may reserve its right to deny coverage for any judgment that might be rendered on a ground not covered by the policy. *E.g., J. C. Penney Cas. Ins. Co. v. M. K.*, 52 Cal.3d 1009, 1017 (1991). Over the years, the tension between the carrier's right to control the defense and its right to deny coverage for the outcome of the defense led courts to imply a right, in certain instances, for an insured to select defense counsel to be paid for by the carrier. The two seminal cases are *Executive Aviation, Inc. v. National Ins. Underwriters*, 16 Cal.App.3d 799 (1971) and *San Diego Fed. Credit Union v. Cumis Ins. Society, Inc.*, 162 Cal.App.3d 358 (1984).

In *Executive Aviation*, 16 Cal.App.3d 799, the insured carrier was sued in connection with an airplane crash. The carrier hired the same counsel to simultaneously defend the insured from the plaintiff's claim and to prosecute a declaratory relief action against the insured to obtain a determination of no coverage on a ground that would have adversely affected the defense of the plaintiff's case. The carrier expressly recognized that the counsel it had retained faced a conflict, but it refused to pay for other counsel for the insured. The appellate court held that in that circumstance, the carrier had to pay the fees of counsel the insured independently retained to defend it.



Robert A. Olson

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In *San Diego Federal Credit Union v. Cumis Ins. Society, Inc.*, 162 Cal.App.3d 358, in addition to potentially covered claims, the complaint against the insured alleged claims for punitive damages and for breach of contract, both of which would not have been covered by the policy. Again, the carrier insisted on selecting counsel, and the insured hired its own counsel. The appellate court, referencing the ethical rules binding attorneys not to represent conflicting interests, found a conflict of interest in the allegations of punitive damages and willful misconduct and held the insured entitled to recover from the carrier its costs in retaining counsel. See also *O'Morrow v. Borad*, 27 Cal.2d 794 (1946); *Bogard v. Employers Cas. Co.*, 164 Cal.App.3d 602 (1985); *Golden Eagle Ins. Co. v. Foremost Ins. Co.*, 20 Cal. App. 4th 1372, 1395-96 (1993).

The classic example of a conflict of interest requiring *Cumis* counsel is where a complaint alleges a single set of damages flowing either from potentially covered negligent conduct or, alternatively, from clearly uncovered intentional conduct. Defense counsel inevitably will have to choose between arguing that any conduct, if wrongful, was merely negligent (in the insured's coverage interest) or that it was intentional (in the carrier's coverage interest).

In the wake of *Cumis*, insureds routinely demanded the right to select counsel to be paid by a carrier. A cottage industry was created and, as with any situation where someone has a limitless charge to spend someone else's money, abuses developed. In response, the Legislature codified, to some extent, the *Cumis* rule in California Civil Code section 2860. Although that section has its genesis in *Cumis*, there are some important refinements of the parties' rights and obligations as codified in section 2860. See *Dynamic Concepts, Inc. v. Truck Ins. Exch.*, 61 Cal.App. 4th 999, 1001 n.1, 1007 n.5 (1998). For historical reasons, though, insured-selected counsel is still often referred to as *Cumis* counsel.

Section 2860 now governs the insured's right to select counsel. It addresses two basic areas: (1) when does the insured have the right to select counsel to be paid for by the carrier and (2) what are the mutual obligations between the insured, insured-selected counsel, and the carrier?

#### **When Does the Insured Have A Right to Select Counsel?**

Even under *Cumis* it was never the rule that an insured always was entitled to select counsel whenever the carrier reserved its rights. Rather, the rule was, and is, that an insured has a right to select counsel at the carrier's expense only where the reserved "ground of noncoverage [is] based on the nature of the insured's conduct, which as developed at trial would affect the determination as to coverage." *McGee v. Superior Court*, 176 Cal.App.3d 221, 226 (1985).

Civil Code section 2860 restates and further refines this standard. Under that statute a conflict of interest imposing a duty on a carrier to pay for insured-selected counsel "may exist" "when...the outcome of [a reserved] coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim..." Cal. Civ. Code, § 2860(b) (emphasis added). But, "a conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage" and "[n]o conflict of interest shall be deemed to exist as to allegations of punitive damages or deemed to exist solely because an insured is sued for an amount in excess of insurance policy limits." *Id.*

What does all this mean?

#### **Where the Insured Clearly Has to Accept Carrier-Selected Counsel**

First, it means that the insured has no right to make the carrier pay for counsel for reasons unrelated to coverage determina-

tions. For example, the insured has no right to select counsel just because the case is an important, high-visibility litigation in which its reputation is at stake. See *Western Polymer Tech., Inc. v. Reliance Ins. Co.*, 32 Cal.App.4th 14, 26-27 (insurance protects the insured from covered liabilities, not for the entirety of its well-being; insured had no action against carrier settling claim even though doing so hurt insured's reputation); cf. *Buss v. Superior Court*, 16 Cal.4th 35 (1997) (carrier only contracts to protect insured from liability on potentially covered claims; any duty to defend other aspects of the litigation is "prophylactic" to prevent injury to the insured while the covered claims are being defended). The insured, however, is always free to hire additional counsel at its own expense to help look after such non-insured interests.

Second, the rule means that a coverage reservation based on something clearly not at issue in the underlying litigation does not give the insured the power to select counsel. Such questions include, for example, whether a driver is a resident relative of the insured auto owner, whether there was a misrepresentation on the policy application, or interpretation of the meaning of policy language, e.g., what constitutes "advertising injury" or a "wrongful eviction". *McGee v. Superior Court*, 176 Cal.App.3d 221 [whether resident-relative exclusion applies]; *Native Sun Inv. Group v. Ticor Title Ins. Co.*, 189 Cal.App.3d 1265, 1277 (1987) ("Coverage of the [disputed] claim turned solely upon interpretation of [the] policy. The [litigation] did not place in issue any rule of law or fact which would bear upon the meaning of [the] policy").

Third, it clearly means that the insured has no right to select counsel on the basis of its exposure to punitive damage claims or damage claims exceeding policy limits. *Dynamic Concepts, Inc. v. Truck Ins. Exch.*, 61 Cal.App.4th at 1006-07 & n.5; *Blanchard v. State Farm Fire & Cas. Co.*, 2 Cal.App.4th 345, 350; *Foremost Ins. Co. v. Wilks*, 206 Cal.App.3d 251. In this regard, section 2860 provides an arguably more limited right for the insured to select counsel than first recognized in *Cumis*.

Beyond these basics, though, section 2860's application can get tricky.

#### **Covered Versus Uncovered Damages**

Sometimes a complaint will seek discrete categories of damages some of which are potentially covered and others of which are not. Thus, for example, a complaint might allege that a contractor's shoddy work (e.g., a leaky roof) both has to be redone and replaced (not covered under most policies) and also resulted in covered damage to other property, e.g., damaged walls, furniture, and flooring. The fact that the complaint seeks both damages covered by the policy and other damages for which the carrier denies coverage, however, generally will not trigger an

#### **Contributors to this Issue**

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insured's right to select counsel. Cal. Civ. Code § 2860(b) ["a conflict of interest does not exist as to allegations or facts in the litigation for which the insurer denies coverage"]; *Blanchard v. State Farm Fire & Cas. Co.*, 2 Cal.App.4th 345; see also *Native Sun Inv. Group v. Ticor Title Ins. Co.*, 189 Cal. App.3d at 1277 (rejecting argument that "to the extent [carrier-selected counsel's] representation could result in liability on the uncovered claims, as opposed to the covered claims," the insured should have right to *Cumis* counsel); *Foremost Ins. Co. v. Wilks* (1988) 206 Cal.App.3d 251 (same as to uninsured punitive claim).

But that may not always be the case. The key is whether coverage for the potentially covered damages depends on (or will be negated by) recovery of the uncovered damages. For example, assume a complaint that alleges both potentially covered trademark infringement and clearly uncovered contract breach. If the factual findings necessary for an award of contract damages cannot affect coverage for trademark infringement, then the insured has no right to select defense counsel. On the other hand, if such findings might defeat coverage for the trademark claim (for example, if the policy excludes from coverage damages arising out of a contract breach and the trademark claim is premised on violation of a contractual trademark license), then there may be a conflict of interest requiring *Cumis* counsel.

One might hypothesize that carrier-selected defense counsel could try to somehow shape the case to emphasize liability for the uncovered damages over liability for the potentially covered damages. The case law, however, rejects such a hypothesis as a basis for awarding the insured the right to select counsel. "The Legislature declined to adopt the absolutist view that insurer-appointed defense counsel will only offer token resistance to claims that fall outside a policy's coverage terms or limits or will steer the defense in a direction favorable to the insurer." *Dynamic Concepts, Inc. v. Truck Ins. Exch.*, 61 Cal.App.4th at 1007 n.5.

#### **The Carrier's Reserved Right to Reimbursement of Defense Expenses for Claims It Never Had A Duty to Defend**

Given the dire consequences of failing to defend, carriers at times will agree to defend even when they think it probable that they have no duty to do so. In such a situation, a carrier may reserve the right to seek reimbursement of the defense fees it pays in the event it obtains a declaration that it never owed a duty to defend. See *Buss v. Superior Court*, 16 Cal.4th 35. Likewise, a carrier may reserve the right to seek reimbursement for the fees it pays for legal services that do not fall within the scope of its duty to defend, e.g., prosecution of counterclaims, defense of claims for injunctive relief. *Id.* Defense counsel's bills, thus, ultimately may be the insured's responsibility. Conceivably, those bills might be used to allocate between fees the carrier has to pay and fees for which the insured is ultimately responsible.

The outcome of the carrier's reserved right to seek defense fee reimbursement, however, is *not* controlled by selected defense counsel. Rather, the duty to defend — and the right to reimbursement — is determined based on what is *alleged* in the tendered action, not what is actually found at trial of that action. *Id.* at 46. Likewise, defense counsel — whether carrier or insured-selected — has neither a duty nor a right to be untruthful about what the services it rendered. Accordingly, the carrier's reservation of a right to reimbursement of defense fees does not afford the insured any right to select counsel. *Dynamic Concepts, Inc. v. Truck Ins. Exch.*, 61 Cal.App.4th at 1008.

#### **Issues Touching Upon Reserved Grounds for Denying Coverage**

The crux of section 2860 is that the insured may have a right to select counsel where "the outcome of [a reserved] coverage

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## **Closing the Doors to Securities Fraud Lawsuits: The View After *Silicon Graphics***

**C**onsider the following not-so-hypothetical securities fraud complaint allegations:

Public Company "X's" forecasts and public pronouncements all pointed to robust, sustained 40%+ growth for the upcoming fiscal year, with earnings being driven by anticipated strong market acceptance of X's newest and hottest computer workstation product. Not surprisingly, X's public stock rises to its all-time trading high. During the several month time period these bullish forecasts and pronouncements are being made, key Company executives are aware through their own internal daily manufacturing, sales and financial reports, as well as monthly reports, of serious computer chip shortages and quality problems seriously affecting product delivery and sales of the new product, but say nothing about these problems. Instead of full disclosure, key Company executives engage in massive insider trading during this same time period, selling Company stock at allegedly inflated prices and realizing nearly \$14 million on such sales. Then, the proverbial "day of reckoning" comes, as the public markets are made aware of the previously undisclosed problems and the Company's stock nose-dives, with numerous shareholder securities fraud lawsuits filed within a short time thereafter.



**Michael A. Sherman**

Sound familiar?

Sure does. And in years past a complaint like this one would have effortlessly sailed past the obligatory defense motion to dismiss, with the District Court judge having no choice but to permit wide-ranging and enormously expensive and intrusive discovery. Thereafter, Company counsel would attempt to marshal facts to avert a trial through a summary judgment defense, all the while posturing the case for an outrageously expensive settlement. But look again, because cases like these may just be a thing of the past:

The recent decision of the 9th Circuit Court of Appeals in *Janas v. McCracken (In Re Silicon Graphics Securities Litigation)*, 1999 U.S. App. LEXIS 14955; Fed. Sec. L. Rep. (CCH) P90,512; 99 Cal. Daily Op. Service 5322; 99 Daily Journal DAR 6829, filed July 2, 1999, as amended August 4, 1999, concurring and dissenting opinion amended August 25, 1999, completely rewrites the result of this hypothetical. Indeed, the above-described hypothetical is essentially what plaintiffs alleged in the amended complaint initiating the *Silicon Graphics* case and the complaint that U.S. District Court Judge Fern Smith (N.D. Cal.) dismissed with prejudice in June, 1997. The Ninth Circuit affirmed that dismissal in its July 2, 1999 decision. *Silicon Graphics* presents the Ninth Circuit's first foray into an analysis of the centerpiece of the Private Securities Litigation Reform Act ("Reform Act") — the change in the requirements for the pleading of securities fraud under Rule 10b-5. Regardless of whether *Silicon Graphics* is reheard by the Ninth Circuit *en banc* (as the *ABTL Report* went to press such petition was pending), the Ninth Circuit's ruling and the rulings of several other Circuit Courts of Appeal appear on a collision course for ultimate resolution by the Supreme Court.

The issue before the court in *Silicon Graphics* centered on how plaintiffs in actions brought under Rule 10b-5 must meet their pleading requirements of the intent to defraud under the

(Continued on page 8)

Securities Exchange Act of 1934 ("34 Act") now that the Reform Act is law. Section 10(b) of the 34 Act makes it unlawful for any person "[t]o use or employ, in connection with the purchase or sale of any security...any manipulative or deceptive device or contrivance." 15 U.S.C. section 78j(b).

Before focusing on the Reform Act requirement, a brief history of the 10(b) intent requirement is in order: Following the decision of the Supreme Court in 1976 in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), that negligence was insufficient to trigger civil liability under section 10(b) and Rule 10b-5, the Court kept open the issue of "whether in some circumstances, reckless behavior is sufficient for civil liability under Section 10(b)." *Id.*, at 194, n. 12. Thereafter, it had been widely accepted throughout the Circuit courts of Appeal that some form of recklessness supports liability under section 10(b) (*see, e.g., Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990); *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1044 (7th Cir. 1977); and, *SEC v. Steadman*, 967 F.2d 636, 641 (DC Cir. 1992)). The standard of recklessness that was adopted in *Hollinger* was borrowed from the decision of the Seventh Circuit in *Sundstrand*, and provides that:

"[R]eckless conduct may be defined as a highly unreasonable omission, involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it."

*Hollinger*, 914 F.2d at 1569.

Pre-Reform Act, the pleading requirement of the intent to defraud varied considerably among the Circuit Courts of Appeal, ranging from the plaintiff-friendly standard in the Ninth Circuit requiring only that securities plaintiffs "aver scienter generally... simply by saying scienter existed" *Decker v. Glenfed Inc. (In re Glenfed Inc. Sec. Litig.)*, 42 F.3d 1541, 1545 (9th Cir. 1994), to the demanding standard in the Second Circuit requiring a plaintiff to plead "facts giving rise to a strong inference of fraudulent intent," which could be satisfied either by alleging facts establishing (1) a motive and opportunity on the defendant's part to commit fraud, or (2) a strong circumstantial evidence of conscious misbehavior or recklessness *Shields v. Citytrust Bancorp. Inc.*, 25 F.3d 1124, 1128 (1994).

This split between the circuits was addressed and resolved by the Reform Act, through the requirement that a complaint under section 10(b) "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." 15 USC section 78u-4(b)(2). Notably absent from the Reform Act itself is any provision that details either how to plead or prove this intent requirement, or just what the state of mind is.

The Reform Act took effect in late 1995, with Congress overriding President Clinton's veto. In his veto message to Congress, the President even went so far as to single out his concern over the then existing (and more exacting) Second Circuit pleading standard as the reason for his disapproval of the proposed legislation; but Congress would not be deterred and did not change the standard in its veto override. The conference report prepared by the House and Senate managers declared that "Congress has been prompted by significant evidence of abuse in private securities lawsuits to enact reforms to protect investors and maintain confidence in our capital markets." H.R. CONF. REP. 104-369, at 31. In general, the conference report makes it clear that Congress designed the Reform Act to deter non-meritorious lawsuits by creating procedural barriers such as heightened pleading standards. *Id.* at 41.

Relying extensively on what many refer to as the contradictory and inconclusive legislative history, the amended opinion of the Ninth Circuit in *Silicon Graphics* specifically rejects the Second

Circuit's "motive and opportunity" test as a method for Reform Act pleading. On the subject of the internal reports which allegedly alerted Silicon Graphics' officers to serious production and sales problems, the court held plaintiffs' allegations were insufficient as they did not include, among other things, adequate corroborating details such as who drafted the reports, which officers reviewed the reports, or the contents of the reports. On the subject of the alleged suspiciously timed insider stock sales, the court reviewed the searching factual inquiry conducted by the District Court and concluded that plaintiffs had not created a strong inference of deliberate recklessness that the stock sales were unusual or suspicious, or "dramatically out of line" with prior insider stock sales. *Id.*, at 47. Plaintiff had alleged that the individual defendants sold nearly \$14 million in Company stock during the approximately fifteen-week class period, but the Court took issue with the claimed percentages of total holdings these sales represented, when considering the total value of all *unexercised* stock options held by the selling defendants. To plead "with [the] particularity [required by the Reform Act], [plaintiff] must provide all the facts forming the basis for her belief in great detail." *Id.*, at 34.

The *Silicon Graphics* decision confirms that recklessness is a form of scienter under 10(b), but requires that the recklessness be "conscious" or "deliberate." In reaching its decision, the Court suggests that it is merely applying the recklessness standard adopted by the *en banc* decision of the Ninth Circuit in *Hollinger v. Titan Capital Corp.*, *Id.* But in other places in the decision it appears that the Ninth Circuit is adopting a recklessness standard that far exceeds the standard enunciated in *Hollinger*. The Court rejects any suggestion that "simple" or "mere" recklessness can suffice as a ground for liability.

The Second and Third Circuits have reached different conclusions than the Ninth Circuit in *Silicon Graphics*. Those circuits hold that a strong inference of scienter can be alleged by showing a motive and opportunity to commit fraud or by showing circumstantial evidence denoting either recklessness or conscious misbehavior. *See In re Advanta Corp. Sec. Lit.*, No. 98-1846, 1999 U.S. App. LEXIS 13332 (3d. Cir. June 17, 1999), and *Press v. Chemical Inv. Serv. Corp.*, 166 F.3d 529 (2nd Cir. 1999). Other circuits appear to acknowledge that while the Second Circuit's "motive and opportunity" test should no longer be employed in determining whether scienter has been plead, under appropriate circumstances the pleading of "motive and opportunity" may be relevant, and that, moreover, recklessness may be satisfied with something less than proof of deliberate recklessness. *In re Comshare, Inc. Sec. Litig.* No. 97-2098, Fed. Sec. L. Rep. (CCH) P90,513; 1999 U.S. App. LEXIS 15068; 1999 WL 460917 (6th Cir. July 8, 1999).

One of the issues that will need to be resolved by the Supreme Court is what standard of recklessness to apply, ranging all the way from gross negligence to conscious or deliberate recklessness, or what one court has characterized as "super recklessness". *Bryant v. Avado Brands, Inc.*, No. 98-9253, 1999 U.S. App. LEXIS 21051, p. 35 (11th Cir. September 3, 1999). It appears that the process of defining recklessness is being turned into a game of semantics, with the danger being that the conclusion in any one case justifies the definition.

The prospect is dim that any Circuit Court decision, or even series of decisions, could resolve the conflicts among the Circuits. Moreover, if the *Silicon Graphics* decision remains the law of the Ninth Circuit, or is adopted as the law of the land by the Supreme Court, it is hard to imagine how any securities fraud class action alleging a fraud on the market claim under section 10(b) could proceed past the pleading stage. As a practical matter, the type of information required by the Ninth Circuit is not available in these types of actions in the early pleading stages, and dismissal is virtually assured under the *Silicon Graphics*

standard. Some critics have suggested that, if this is what Congress had in mind with the Reform Act legislation, then perhaps it would have been easier to just have banned 10(b) class action claims altogether.

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In the over three and one-half years of securities litigation practice following the passage of the Reform Act, many observers and commentators have remarked that the laudable, anticipated effects of the Reform Act have been slow in coming, that the filing of new lawsuits in fact increased instead of decreasing, and that the hoped-for changes did not appear to be borne out in any measurable and material way. *Silicon Graphics* shows us that the pendulum is now swinging far in the opposite direction.

*The views expressed in this article are the author's own and do not necessarily represent the views of Alschuler, Grossman, Stein & Kahan LLP or its clients.*

— Michael A. Sherman

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### Insured-Selected Independent Counsel

*Continued from page 7*

issue can be controlled by counsel first retained by the insured for the defense of the claim." Cal. Civ. Code § 2860(b). Where the issues in the defended action arguably touch upon those that will determine coverage, the question of whether appointed defense counsel sufficiently "controls" determination of the coverage issue to require *Cumis* counsel can be close and factually intense. At the outset, section 2860 says that where counsel can control the outcome of a coverage issue in the underlying action, a conflict of interest necessitating *Cumis* counsel only "may exist," not that it *does* exist. *Id.* This means that a hypothetical or attenuated possible conflict between the carrier's and the insured's interest is not going to trigger a right to *Cumis* counsel. *Dynamic Concepts, Inc. v. Truck Ins. Exch.*, 61 Cal.App.4th at 1006-07, 1008 ("A mere possibility of an unspecified conflict does not require independent counsel. The conflict must be significant, not merely theoretical, actual, not merely potential."); see *Spindle v. Chubb/Pacific Indem. Group*, 89 Cal.App.3d 706, 713-14 (1979) (no conflict of interest requiring separate counsel where two insured's interests hypothetically might have diverged in the future); see also *Federal Home Loan Mortgage Corp. v. La Conchita Ranch Co.* (1998) 68 Cal.App.4th 856, 862-63 (improper to disqualify counsel for merely hypothetical conflict in the event a particular settlement offer might be made).

On the other hand, where the insured's and the carrier's interests are clearly and presently at odds, the right to *Cumis* counsel undoubtedly arises. *E.g.*, *Golden Eagle Ins. Co. v. Foremost Ins. Co.*, 20 Cal.App.4th at 1395-96 (defense counsel faced an actual conflict of interest as carrier wanted to settle for an amount in excess of the policy limits and the insured did not agree; the insured and the carrier were directing defense counsel to do diametrically opposite things). The same is true where the issues to be litigated dictate that counsel necessarily or very likely will face a choice between promoting the insured's or the carrier's coverage position in the future.

Whether approached from the perspective of counsel advising an insured or coverage counsel for the carrier, the critical inquiry regarding the right to *Cumis* counsel is: Will the manner in which the case is defended necessarily, or at least very likely, involve a choice by defense counsel that can make or break the reserved coverage determination for either the insured or the carrier?

#### Defense Counsel's Ability to Sabotage Coverage

But what about the prospect that carrier-selected defense counsel might "throw" the coverage determination by conceding

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## Cases of Note

### Civil Procedure

In *Jewish Defense Organization, Inc. v. Superior Court*, 1999 Daily Journal D.A.R. 5673 (Ct.App. June 8, 1999), the Second Appellate District held that defendants' conduct of contracting, via computer, with Internet service providers which are California corporations or maintain offices or databases in California, is insufficient to constitute purposeful availment of jurisdiction for purposes of establishing specific jurisdiction.

In *People ex rel. Dept. of Corporations v. Speedee Oil Change Systems, Inc.*, 1999 Daily Journal D.A.R.7567 (Cal., July 27, 1999), the California Supreme Court held that for purposes of disqualification, an "of counsel" attorney is considered affiliated with a firm so that the disqualification of either the "of counsel" or the firm must be imputed to the other.

In *Cates Construction, Inc. v. Talbot Partners*, 1999 Daily Journal D.A.R. 7725 (Cal., July 29, 1999), the California Supreme Court held that a performance bond guaranteeing that the contractor will "promptly and faithfully perform the construction contract" obligates the surety issuing the bond to answer for delay damages caused the contractor's failure to timely complete the construction work. The Court further held that a construction performance bond is not an insurance policy and that the obligee under the bond may not recover in tort for breach of the implied covenant of good faith and fair dealing.



Denise M. Parga

### Arbitration

In *Domingo v. Los Angeles County Metropolitan Transportation Authority*, 1999 Daily Journal D.A.R. 8791 (Ct. App., August 24, 1999), the Court of Appeal held that the thirty-day period specified in Rule 1615 of the California Rules of Court for filing for a trial de novo from an arbitrator's award does not run until the arbitrator effects proper service of the award on the parties.

In *Erlich v. Menezes*, 1999 Daily Journal D.A.R. 8687 (Cal., August 23, 1999), the California Supreme Court held that a plaintiff may not recover damages for emotional distress based on a defendant's negligent breach of a contract to build a house when the defendant has breached no duty independent of the contract.

In *White v. Ultramar, Inc.*, 1999 Daily Journal D.A.R. 8693 (Cal., August 23, 1999), the California Supreme Court held that a "managing agent" for purposes of imposing punitive damages under Code of Civil Procedure section 3294(b) includes only those corporate employees who exercise substantial independent authority and judgment in their corporate decisionmaking so that their decisions ultimately determine corporate policy.

In *Vandenberg v. Superior Court*, 1999 Daily Journal D.A.R. 9035 (Cal., August 23, 1999), the California Supreme Court held that a private arbitration award, even if judicially confirmed, may not have nonmutual collateral estoppel effect under California law unless there was an agreement of the parties. In addition, the Supreme Court reversed a long line of decisions which held that contract damages are not covered under the coverage phrase "legally obligated to pay as damages" used in CGL insurance policies, holding that a CGL policy may provide an insured defendant with coverage for losses pleaded as contractual damages. According to the Court, the nature of the risk and the injury determines coverage, not the form of the remedy.

— Denise M. Parga

an adverse coverage fact in the underlying litigation even though it might not be a necessary issue in that litigation? For example, what about the prospect that defense counsel might request a special interrogatory to the jury as to when the injury or offense occurred (*e.g.*, within or outside the policy period), even though there is no statute of limitations issue? Such a prospect does not suffice to afford a *Cumis* counsel right. To be controlled in the underlying litigation, the identified issue must be one necessary to the underlying litigation.

It is not presumed that carrier-selected defense counsel will breach the ethical duties owed as much to its client, the insured, as to its client, the carrier, by gratuitously introducing issues into the underlying litigation that are not already there. See *Dynamic Concepts, Inc. v. Truck Ins. Exch.*, 61 Cal.App.4th at 1007 n.5, 1008, 1010 n.10. If such were the case, a *Cumis* right would be triggered even where the coverage issue is entirely extrinsic to the litigation, because unethical defense counsel could *always* gratuitously introduce an issue or make a concession regarding coverage. The situation is no different than a lawyer representing McDonald's and Burger King in a claim made jointly against them. McDonald's and Burger King might be competitors who would each like to see the other fail and might even have litigation between themselves, but there is no ethical presumption that counsel representing both in an action brought by a third party would act to torpedo one's interest out of spite. Should carrier-selected defense counsel violate the duty owed to the insured client by gratuitously acting to further the carrier's coverage interest at the insured's expense, the client will have a claim against defense counsel. See *Betts v. Allstate Ins. Co.*, 154 Cal.App.3d 688 (1984) (carrier and counsel liable to insured where counsel wrongfully favors interests of carrier over those of insured); *Mosier v. Southern Cal. Physicians Ins. Exch.*, 63 Cal.App.4th 1022 (1998) (counsel and carrier providing a "courtesy" defense to an uninsured co-defendant can be liable if counsel shapes defense to benefit covered co-defendants to "courtesy" defendant's detriment).

#### **The Mutual Obligations Between *Cumis* Counsel and Carrier**

When a carrier provides *Cumis* counsel, Civil Code section 2860 also governs numerous aspects of the relationship between the insured, *Cumis* counsel, and the carrier.

#### **Counsel's Qualifications**

First, it limits who the carrier must accept as *Cumis* counsel. Although the carrier may have reserved its right to deny coverage, it still has a substantial interest in how the case is defended. Its reservation may not prevail. Most cases settle, inevitably at some expense to the carrier. And, the carrier will be footing at least part of the defense bill.

The carrier thus has an interest in having competent counsel to defend the action. To that end, section 2860, subdivision (c) provides that the carrier can insist that the selected counsel have five years' civil litigation experience, including "substantial" defense experience in the issues being litigated, and have errors and omissions coverage.

The statute, however, does not define what is "substantial" defense experience, whether *each* attorney working on the case has to meet the qualifications, or what level of errors and omissions coverage has to be provided. Carriers — in the insurance contracts themselves or even by consistently applied practice — should be able to impose *reasonable* interpretations; subdivision (c) "does not invalidate other different or additional policy provisions pertaining to attorney's fees." Cal. Civ. Code § 2860(c). Indeed, "the duty of good faith imposed upon an insured includes the obligation to act reasonably in selecting as independent coun-

sel an experienced attorney qualified to present a meaningful defense." *Center Found. v. Chicago Ins. Co.*, 227 Cal.App.3d 547, 560 (1991).

#### **Attorney's Fees**

Subdivision (c) also *limits the hourly or other rate* at which the carrier has to pay *Cumis* counsel. "The insurer's obligation to pay fees to the independent counsel selected by the insured is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in defense of similar actions in the community where the claim arose or is being defended." This provision has been the subject of much debate by insureds, their counsel, and carriers.

At heart, the provision is a non-discrimination provision. The carrier may not provide less compensation to *Cumis* counsel than it provides to counsel for insureds it defends without any reservation. By the same token, however, an insured with a right to *Cumis* counsel is not entitled to a Rolls Royce defense when other insureds, who paid the same premiums, are receiving Chevrolet defenses on claims for which there is no right to select *Cumis* counsel. Nothing in the statute suggests that it is a guarantee of a "fair" or "general market" level of compensation to counsel. The parties are also free to include in the policy other alternative provisions pertaining to attorney's fees. *Id.*

Some have argued that *Cumis* counsel should be entitled the same rates that the carrier pays to defend itself from lawsuits, in other words, that a carrier should not be able to discriminate between what it pays to defend itself and what it pays to defend its insureds. But the types of lawsuits against insurance carriers — *e.g.*, insurance bad faith — typically are not similar to actions pursued against insureds and, thus, not within the scope of section 2860. To the extent that there are disputes about the appropriate *Cumis* rate — *i.e.*, over what is a similar case or what rate the carrier pays in the ordinary course of business to defend such cases — the statute mandates binding arbitration. *Id.*

Complex problems arise where more than one insurance carrier has a duty to defend. An insured might argue that the collateral source rule should allow it to "stack" the rates typically paid by each carrier to obtain a more generous rate. On the other hand, such an argument would appear to run counter to the statute's apparent purpose to limit carriers' obligations to those that they would incur if they were defending without a reservation of rights, and, potentially, to other insurance clauses in the policies. No published decision has resolved this issue.

The insured, of course, is always free to compensate counsel beyond what the carrier pays. But, as a matter of ethics and competence, counsel may have to fully inform the insured of the possibility of accepting carrier-selected counsel at no additional expense and the risks or lack of risks posed by being represented by such counsel (see discussion in section 4, below). Sometimes it will be more economical for the insured to accept carrier-selected counsel willing to accept the carrier's rate as full compensation and to hire separate counsel to oversee and monitor the handling of the case on the insured's behalf.

Finally, section 2860 only applies where "the provisions of a policy of insurance impose a duty to defend upon an insurer." Cal. Civ. Code § 2860(a). The limitations on counsel's rates, thus, should not apply to policies that merely reimburse the insured for the expenses *the insured* incurs in retaining counsel to defend a claim (many directors and officers policies are written in this manner, see *Gon v. First State Ins. Co.*, 871 F.2d 863, 868 (9th Cir. 1989); *Okada v. MGIC Indem. Corp.*, 823 F.2d 276, 280 (9th Cir. 1986).).

Even before section 2860, the insured's good faith obligation required *Cumis* counsel "to engage in ethical billing practices sus-

*(Continued next page)*

ceptible to review at a standard stricter than that of the marketplace." *Center Found. v. Chicago Ins. Co.*, 227 Cal.App.3d at 560. *Cumis* counsel, thus, needs to comply with any reasonable billing guidelines that a carrier might impose on all counsel, whether carrier-retained or insured-selected (e.g., billing in 1/10ths of an hour, no block billing, adequate task description, appropriate use of attorneys and paraprofessionals). Such guidelines, however, may cross the line to the extent they interfere with the professional judgment of counsel (whether carrier-retained or *Cumis* counsel), e.g., if they dictate what procedural steps counsel may or may not employ. *Dynamic Concepts*, 61 Cal.App.4th at 1009 n.9.

### Who Is the Client

*Cumis* counsel has only one client – the insured; *Cumis* counsel owes neither a duty of loyalty nor a duty of competence to the carrier. *Assurance Co. of America v. Haven*, 32 Cal.App.4th 78 (1995). By contrast, carrier-appointed counsel has two clients, the insured and the carrier, and it owes duties of loyalty and competence to both. *Unigard Ins. Group v. O'Flaherty & Belgum*, 38 Cal.App.4th 1229 (1995).

### Cooperation Between *Cumis* Counsel and the Carrier

Although the carrier is not strictly *Cumis* counsel's client, section 2860 both makes privileged communications between *Cumis* counsel and the carrier and requires both *Cumis* counsel and the insured to communicate and cooperate with the carrier. For example, *Cumis* counsel is required to timely communicate and consult with the carrier about the status and evaluation of the case. Cal. Civ. Code § 2860(d) & (f). This is often a bone of contention with carriers used to, and entitled to, regular status reports. Some carriers, with arguable justification, refuse to pay *Cumis* counsel's bills until they receive outstanding status reports. The only limitation on the reporting requirement is that *Cumis* counsel need not (and ethically should not) divulge privileged information relating to coverage disputes. *Id.*

Section 2860 also requires the insured to allow any additional counsel selected by the carrier to participate fully in the litigation and otherwise to cooperate fully according to the insured's duties under the policy. A difficult issue arises where the carrier is defending because of potential coverage for only one of several claims against the insured. E.g., *Buss v. Superior Court*, 16 Cal.4th 35. The carrier might wish to appoint counsel for the purpose of obtaining summary disposition of that one claim on the basis that it is legally or factually groundless, thereby setting the stage for the carrier to withdraw from the defense. See *Val's Painting & Drywall, Inc. v. Allstate Ins. Co.*, 53 Cal.App.3d 576, 584 (1975). Either section 2860 or the insured's implied obligation to the carrier of good faith and fair dealing may require the insured to allow the carrier to do so, potentially depriving the insured of the carrier's further assistance in defending noncovered claims. But no case has decided the issue.

### The Remedy If A Carrier Refuses to Appoint *Cumis* Counsel

But what happens if an insured is entitled to *Cumis* counsel and has attempted to select reasonable counsel, but the carrier nonetheless insists on retaining only its chosen counsel? The insured has several important remedies, but it should not be able to transform such a *Cumis* misstep into a windfall equivalent of a failure to defend.

First, an insured may pursue "a declaratory relief action...to establish the right to independent counsel"; the insured is entitled to have that action determined on an expedited basis. *United States Fidelity & Guar. Co. v. Superior Court*, 204 Cal. App.3d 1513, 1526 (1988). This determination of the insured's entitlement to *Cumis* counsel is not subject to section 2860's mandate that issues concerning *Cumis* counsel's fees be arbitrated. Rather, absent some other policy provision, the issue must be

resolved in court. *Truck Ins. Exch. v. Dynamic Concepts, Inc.*, 9 Cal.App.4th 1147 (1992); *Handy v. First Interstate Bank*, 13 Cal.App.4th 917 (1993).

Second, the insured can go ahead and retain counsel of its own choosing to represent it, paying for that counsel itself. If the insured, in fact, was entitled to select *Cumis* counsel, the carrier will be liable for the expenses the insured pays. E.g., *O'Morrow v. Borad*, 27 Cal.2d 794; *Executive Aviation, Inc. v. National Ins. Underwriters*, 16 Cal.App.3d 799; *San Diego Fed. Credit Union v. Cumis Ins. Soc'y, Inc.*, 162 Cal.App.3d 358; *Bogard v. Employers Cas. Co.*, 164 Cal.App.3d 602. In that event, the carrier likely is going to be responsible for the full amount paid to the *Cumis* counsel without the benefit of Civil Code section 2860's rate limitations. See *State of California v. Pacific Indem. Co.*, 63 Cal.App.4th 1535, 1540 (1998) (insured entitled to actual defense expense it incurred without regard to greater "market rate" or contingent bonus to be paid only upon finding of insurance coverage; suggesting, however, that where carrier mistakenly refused to pay for *Cumis*, carrier has to pay counsel's full rate charged to and paid by insured).

Insureds retaining *Cumis* counsel for which a carrier refuses to pay must be careful, however, not to exclude the carrier or the carrier's selected counsel from the defense. The carrier's refusal to pay for *Cumis* counsel may not relieve the insured (and the insured's selected counsel) of the obligations imposed by both section 2860 and the implied covenant of good faith and fair dealing to cooperate with the carrier in the defense of the action. Further, if a court later does not agree that the insured is entitled to *Cumis* counsel and the insured has refused to cooperate with the carrier or to allow the carrier to participate in the defense of the action, the insured may jeopardize its coverage rights by having failed to accept the carrier's offered defense.

Third, the insured can accept the defense offered by the carrier. Should a judgment be rendered on a ground on which the carrier has reserved the right to deny coverage, in most instances the carrier will be estopped to deny coverage on that ground. Thus, in *Tomerlin v. Canadian Indem. Co.*, 61 Cal.2d 638 (1964), the California Supreme Court held that where an insured acceded to the carrier's request to replace his selected independent counsel with counsel of the carrier's selection, the carrier was later estopped from asserting noncoverage for excluded intentional acts. One exception, however, may be any eventual punitive damage liability. In *PPG Indus., Inc. v. Transamerica Ins. Co.*, 20 Cal.4th 310 (1999), the Supreme Court held that a carrier's wrongful failure to settle a claim within policy limits was not a proximate cause of a later punitive damage award, finding the true proximate cause to be the insured's underlying malicious conduct. If a wrongful failure to settle is not a proximate cause of a later punitive award, then the mistaken provision of a defense through carrier-selected rather than *Cumis* counsel may also not proximately cause any resulting punitive damages.

The one thing that the insured may not do when faced with a carrier's refusal to provide *Cumis* counsel, assuming that the carrier offers a defense through carrier-selected counsel, is to decline to mount any defense at all. The carrier in that circumstance is not responsible for any ensuing settlement or default judgment. An insured unhappy with the defense the carrier is providing — either because it is not being provided by *Cumis* counsel or because the insured thinks that it is less than competent — has no right to abandon that defense. "[N]either the adequacy of the representation nor the effectiveness of the defense are relevant to the question whether the insured can enter into a binding settlement without the insurer's consent.... Unless and until an excess judgment is rendered giving rise to a possible bad faith action...the effectiveness of the representation provided by

(Continued on page 12)

[the carrier] is not at issue." *Safeco Ins. Co. v. Superior Court*, 71 Cal.App.4th 782, 789-90 (1999). Thus, "the insurer [does not] breach its duty to defend when it assigns competent outside counsel pending a further analysis of the *Cumis* issue." *Dynamic Concepts, Inc. v. Truck Ins. Exch.*, 61 Cal.App.4th at 1006; see also *Hartford Fire Ins. Co. v. Spartan Realty Int'l, Inc.*, 196 Cal.App.3d 1320, 1327 & n.3 (1987) (carrier not estopped to deny coverage where it "failed to offer *Cumis* counsel...to [the insured]" because "the remedy crafted by *Cumis* was the retention of independent counsel, not voiding the reservation of rights"; *State Farm Fire & Cas. Co. v. Jioras*, 24 Cal.App.4th 1619, 1628-29 (1994) (rejecting insureds' claim that the failure to retain separate counsel estopped the carrier from denying coverage: "Appellants claim 'detrimental reliance' is shown merely by their failure to hire separate counsel to represent their interests.... [F]ailure to retain separate counsel does not by itself show any detriment").

The *Cumis* or Civil Code section 2860 right is provided to protect the insured from the prospect that it may unwarrantedly be held liable for an uncovered claim. But just as in other contexts, the insured suffers no damages — and has no claim against the carrier — unless and until the defense the carrier provides in fact results in a judgment that the carrier refuses to cover. See *Finkelstein v. 20th Century Ins. Co.*, 11 Cal.App.4th 926, 929-30 (1992) (where carrier wrongfully fails to settle, insured is not damaged — and has no right of action — until defense carrier offers results in uncovered judgment); *Doser v. Middlesex Mut. Ins. Co.*, 101 Cal.App.3d 883, 892 (1980); *Brown v. Guarantee Ins. Co.*, 155 Cal.App.2d 679, 690 (1957).

### Conclusion

The insured's right to select *Cumis* counsel will not always be apparent. The right, at times, can be "vague, ephemeral and highly theoretical." *Dynamic Concepts, Inc. v. Truck Ins. Exch.*, 61 Cal.App.4th at 1009-10. Counsel and clients must thoroughly think through where they are going and what they hope to achieve in contesting a carrier's decision not to afford *Cumis* counsel before expending undue energy and resources on what may be limited benefits to the client.

— Robert A. Olson

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### Letter from the President

*Continued from page 5*

grams is no less important than the space we reserve for that client at counsel's table in the courtroom at trial. We should make a place not just for our in-house lawyer clients, but for the CFO's and CEO's to whom they report as well.

If I have a personal goal for my year at the helm of the Los Angeles Chapter of the ABTL, then, it is to increase attendance at and participation in our programs not just by lawyers and judges, but also by the clients who go to trial with us. We will do our best to make the ABTL's 1999-2000 programs of interest to our members' clients, but our members need to do their part. Making the invitation is as simple as visiting the ABTL website ([www.abtl.org](http://www.abtl.org)) and forwarding a program announcement to a client with a click of your mouse. The fact is that our clients' interest in ABTL programs already exists; if it doesn't, it should and can be developed, for business clients already know that some cases cannot be won on summary judgment, that some cases cannot be settled, and that some cases will go to trial. That's why they come to ABTL members in the first place, and it's why we should encourage them to learn more about what we do before they experience it only from the shuttlecock's standpoint.

Finally, as I assume my responsibilities as President for the 1999-2000 ABTL year, I join our continuing and new Board of Governor members, all distinguished members of the bench and bar, in saluting Dick Burdge of Dewey Ballantine for his outstanding work over the past year at our helm. A tireless volunteer of his precious time to the ABTL and to other activities benefitting both bench and bar, Dick has been an inspiration to us all.

Thanks also to all our members for their continuing support of the ABTL. Thanks to all of the judges who attend and participate in our programs and who help us learn to communicate better in their courtrooms. The 1999-2000 Board of Governors will continue to strive to make your participation in the ABTL a valuable use of your time.

*"Battledore and shuttlecock's a wery good game, when you an't the shuttlecock and two lawyers the battledores, in which case it gets too excitin' to be pleasant."* Charles Dickens, *Pickwick Papers*, 1836-37.

— Jeffrey C. Briggs

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